

PUBLIC SERVICE COMMISSION OF WISCONSIN

Memorandum

July 31, 2003

TO: The Files

FROM: Gas Accounting Team
Natural Gas Division

RE: General Guidelines for Accounting for Manufactured Gas Plant Site Clean-up Costs
(This is an update of earlier versions, dated December 14, 1993, April 11, 1996, and February 4, 1999.).

Effective Date: January 1, 2004

The environmental concern regarding the clean-up of former sites of manufactured gas production has been a continuing problem in the utility industry. Site remediation is necessary to contain or remove contaminating waste caused by the gas manufacturing process used during the 1800s and early 1900s. The costs associated with the clean-up of these sites can be significant. Since there is a great deal of uncertainty as to the level and timing of these costs, FERC, other states, and the PSCW have established policies regarding the proper regulatory treatment for manufactured gas plant (MGP) site clean-up expenditures.

This memo addresses the current PSCW accounting treatment policies for MGP clean-up costs. Concerns regarding rate impacts, cash flow and capital structure, intergenerational equity, and rate case timing shaped the following guidelines.

Treatment When Actual Clean-up Costs Exceed Insurance Recoveries

1. Internal MGP clean-up costs (utility labor and associated overheads, vehicle expenses, training, meetings and conferences, etc.) should be expensed immediately rather than deferred. This eliminates the possibility of these costs being recovered in rates twice: initially included in revenue requirement as a budgeted O&M expense and, secondly, as an amortization expense in a future rate proceeding.
2. External clean-up costs (labor and other costs charged to the utility by outside contracted services) may be deferred. This includes preliminary testing.
3. Amortize actual deferred costs only after such costs have been reviewed and approved by Commission staff. Insurance settlement recovery dollars should also be reviewed by Commission staff. In most cases staff will review these costs during normal rate case reviews or "non-filing" reviews. In the case of rate freezes, Commission staff will review actual costs on the same schedule that coincides with a company's rate case filing schedule.

4. Deferred MGP clean-up costs should be amortized on a vintage, or year by year, approach, rather than on a project basis.
5. Deferred MGP clean-up costs should be amortized over a four to six year period. Materiality should be taken into consideration.
6. After remediation has been completed, the utility will usually need to collect and analyze groundwater samples, continue treatment of the groundwater and prepare reports for an indefinite period of time. These post-clean-up costs, or ongoing maintenance related expenditures, should be expensed immediately, as incurred.
7. The amortized expense and the ongoing level of maintenance expenditures related to MGP clean-up should be charged to Account 735, Miscellaneous Production Expenses.
8. For the smaller utilities that are not required to file rate case data on a scheduled basis, those utilities should file a cost summary report with Commission staff at the time of their next rate application or when a clean-up project has been completed, whichever occurs first. At that time, a determination will be made regarding the amortization period for Commission approved costs.
9. For the larger utilities (those that file rate case data on a biennial schedule), amortizations should begin with the next scheduled biennial rate proceeding/test period, regardless of whether or not there was a requested rate change in their application. This will minimize capital structure impacts by beginning the amortizations of deferred costs as quickly as prudently possible. Amortizations that begin in conjunction with the next scheduled biennial rate case will minimize the total deferred balance and the associated capital needs. Thus, any proposed rate freeze or rate incentive proposal should be evaluated by the utility from the perspective that includes existing amortizations of deferred MGP clean-up costs, as well as any new amortizations that would begin during the normal biennial test period.

Treatment When Insurance Recoveries Occur Before Clean-up

The above guidelines apply and, additionally:

10. If insurance recoveries/settlements have been received by the utility before actual clean-up has occurred, or insurance recoveries are in excess of costs, and the utility's clean-up activity is not imminent, net insurance recoveries should be amortized back to ratepayers in the same manner that costs would be amortized.
11. If insurance recoveries/settlements have been received by the utility before actual clean-up has occurred, or insurance recoveries are in excess of costs, and the utility's clean-up activity is imminent (in an amount that would materially deplete or offset the insurance recoveries), net insurance recoveries should not be immediately amortized back to ratepayers. However, to be consistent with Commission policy, the test year revenue requirement should exclude the net impact on working capital associated with the unamortized balance of deferred MGP clean-up dollars, including any insurance

settlements. In this particular example, in order for ratepayers to receive the appropriate time value of money associated with the insurance settlements, a “pro-forma” or “as if” amortization should be computed for working capital purposes when calculating the test year revenue requirement.

The “as if” calculation should compute the time value of money related to the insurance recoveries that would have been returned to ratepayers over the test period, if the settlement dollars had been amortized back to ratepayers in the same manner that actual costs would be. The “as if” calculation should compute the time value of money by using an amount equal to the utility’s weighted cost of capital, as estimated in a company’s current rate case docket, times the average after-tax amount that would have been amortized, based on the guidelines. This time value of money impact should be included in the net insurance recovery balance. In this way, ratepayers receive the time value of money for the recovery dollars that could have been returned to them through an amortization process, and the shareholders receive the overall cash flow benefit of receiving recovery dollars before clean-up costs are incurred.

If, in the next rate case, review of clean-up activity shows that it did not materially occur as planned, settlement/recovery dollars should be returned to ratepayers as noted above.

12. Amortization of insurance recoveries should be recorded as a contra-expense item in Account 735, Miscellaneous Production Expenses.
13. If a given situation does not mesh with the listed regulatory concerns, common sense should prevail. Extenuating circumstances should be taken into consideration.
14. The following dockets are those in which these (or earlier versions) MGP guidelines were first followed.

Wisconsin Power and Light Company: 6680-UR-108, dated October 1, 1993.

Wisconsin Fuel and Light Company: First in 6640-GR-104, dated December 23, 1992 (but the treatment in 104 was different, MGP costs were collected in a subject to refund surcharge). Next in the order, docket 6640-GR-105, dated October 29, 1993.

Wisconsin Gas Company: 6650-GR-111, dated November 12, 1993, and in a letter order related to a Commission memo dated October 28, 1997, docket 6650-GR-112 (PARM).

Northern States Power Company: 4220-UR-109, dated November 27, 1996.

Wisconsin Electric Power Company: First in a letter order to Mr. David Porter, under the dockets 6630-UR-108/6630-GR-109, and then in the order, docket 6630-UR-109, dated February 17, 1997.

Wisconsin Public Service Corporation: 6690-UR-110, dated February 25, 1997, and then in the order, docket 6690-UR-111, dated January 15, 1999, (this docket included a pro forma amortization related to insurance recoveries).

Cc: Hard copy filed in ARRRID database folder of MGP information
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